

Areas of Recurring Taxpayer Noncompliance

Returns Processing Center (RPC)

Math Calculation

Erroneous math calculations are the chief error made on all forms. The error rate is much higher on paper returns of all tax types than on electronically filed returns. The following is a brief listing of the highest percentage of errors by filing method and tax type:

- Individual 2-D Bar code returns: W-2 detail information missing
- Individual paper-filed returns: state and county tax miscalculations
- Estimated tax: claiming incorrect amounts
- Individual electronically filed returns: missing codes for deductions and credits
- Corporate paper-filed returns: math calculation errors
- Corporate electronically filed returns: estimated tax claiming incorrect amounts
- Sales tax paper-filed returns: duplicate filings
- Withholding tax paper-filed returns: duplicate filings

Post Filing Coupon (PFC)

Post filing coupons are used to pay additional tax on the Indiana individual income-tax return. For scanning equipment to properly recognize taxpayers and the amounts of their payments, PFC's must have the dollar amount and scanline in an "OCR-A Extended" font. When this is not the case, the Department may issue erroneous tax notices.

The Department has found that the scanlines on coupons from some tax practitioners are not printed in the correct font. While the software they are using is capable of printing the correct font, it is possible to install the software without the fonts or to lose the fonts when other updates are made. When an incorrect font is used, the high speed check processing equipment cannot read it, and manual keying is required.

Duplicate Returns

Some taxpayers file returns electronically, as well as paper copies of the same returns, thus creating duplicate returns. The second duplicate return received by the Department's computer system will "suspend" and must be reviewed individually. If for some reason the electronically filed federal/state return is the duplicate return, it is automatically rejected and will not create a suspended document.

Filing the Wrong Return

The Department receives numerous returns each year which are either:

1. On the correct forms but for the wrong year, or
2. On the wrong forms but for the correct year.

An example would be taxpayers submitting IT-40EZ forms, even though they do not qualify for that form because of income type or deductions.

Taxpayers who are residents of reciprocal states often file an Indiana Form IT-40 and take their home state's deductions rather than filing the appropriate Indiana Form IT-40RNR (reciprocal nonresident). The Department has found that several taxpayers are filing an IT-40RNR to claim a full refund on tax withheld on gambling winnings. Education is required at practitioner schools.

Missing W-2 Detail on 2-D Barcoded Returns

In 2004, the Department began requesting the detailed W-2 information on 2-D barcoded returns from software vendors so that the Department's Returns Processing System (RPS) could validate the amounts being claimed as Indiana state and county withholding on the IT-40.

During the 2006 processing season, even though most 2-D barcoded returns did include the detailed W-2 information, the Department still received more than 100,000 2-D barcoded returns that did not.

This problem is not limited to one particular software vendor. The majority of these 2-D barcoded returns with missing W-2 data came from Intuit's professional users. In most cases, the employers' federal identification (I.D.) numbers were missing. Thus, all W-2 information was dropped. The Department experienced this issue with the software companies of CCH Incorporated, Creative Solutions, Drake Enterprises, H & R Block, TaxWorks, Petz Enterprises and Intuit.



With the growing number of 2-D barcoded returns missing this data, and the fact that hard copies of the W-2 forms were attached to the 2-D barcoded returns in most cases, the Department is researching this matter to see what can be done internally to alleviate this issue.

Failure to Comply with Enterprise Zone Deduction

Taxpayers who live in enterprise zones and work for qualified employers in those zones may be qualified to take the enterprise zone deduction. The deduction is one-half of the earned income shown on Form IT-40QEC, or \$7,500, whichever is less. In most cases, the deductions are calculated incorrectly, or the Form IT-40QEC that should be completed and submitted by the employers is not attached to the taxpayer's Form IT-40. In the case of electronic returns, the IT-40QEC is not being submitted by the preparers, as instructed, on a regular basis.

Trust Taxes – Retail Sales and Use Tax and/or Withholding Tax

- Taxpayers send incomplete registration information to the Department, which delays completing tax registrations, assigning state I.D. numbers prior to filing payments and coupons. Taxpayer location information and incomplete responsible officer information can delay registration of the taxpayer.
- Taxpayers fail to use Department-generated tax returns. This causes incomplete and/or incorrect information to be filed. These returns cannot be automatically processed and must be suspended for manual review and correction before posting to taxpayer accounts.
- Taxpayers and/or tax preparers do not always use the Indiana Taxpayer Identification Number (ITID) or do not use the complete number on returns, correspondence and checks. Correct posting requires the full and correct taxpayer account number.
- Taxpayers fail to use or use incorrect information when changing addresses and/or closing the business or the location. This causes incorrect filing periods and problems contacting the taxpayer. Trust taxes require taxpayers to file returns for each period covered from registration to permanent close of business.
- Amended returns correcting information previously filed are not clearly marked. This causes duplicate period filings that require manual review prior to account posting.

Corporate Income Tax

- Taxpayers are not entering their correct Indiana-issued ITID in the Indiana Taxpayer Identification Number field on tax forms. They are entering their Federal ID, a variation, or shortened version of the ITID.
- For tax periods beginning in 2002 and ending in 2003, the Department requires the IT-20 "fiscal" return and has sent out several mailings with the correct corporate return included. However, taxpayers continue to file the incorrect return.
- When claiming withholding credits on Forms IT-65 or IT-20S, taxpayers are not attaching the WH-18s as verification of the credits claimed. Credits without this verification cannot be allowed.
- Taxpayers are not answering the question, "Is an extension of time to file attached?" on their Indiana corporate returns (e.g., IT-20, IT-20S, IT-65) when state or federal extension forms are attached.

Missing Earned-Income Credit Data on Indiana Electronically Filed Returns

Although, this has been reduced automatically for the past three years, the Department has received electronically filed Indiana IT-40 tax returns with taxpayers claiming the Indiana earned-income credit, but omit some or all of the data from the electronic Indiana IN-EIC schedule.

Tax software is supposed to carry the data entered on the Federal EIC schedule through to the Indiana IN-EIC schedule, eliminating the need for the user to key in the data twice. However, whenever the designated child is someone other than a natural child, grandchild or foster child (niece, nephew, sister, brother), often none or part of the required information does not carry through properly.

The Department again brought this issue to the attention of the affected software companies last year, and most had fixed the problem. However, at the beginning of the 2006 filing season, the Department experienced this same issue with some vendors. The Department contacted the software vendors whose software was still creating this issue early, and all appear to have fixed the issue. The Department does not anticipate that this will be an issue for the 2007 filing season.

Returned Checks

The bills sent to taxpayers who have paid the Department with a check for nonsufficient funds specify that the resulting liability must be satisfied by payment in the form of cash, certified check or other guaranteed payment. Taxpayers often send uncertified checks to pay these liabilities, which can result in additional checks being returned for nonsufficient funds.



Efforts and Achievements

Compliance Division

Aeronautics/Tax Clearances Section

The aeronautics section mailed 5,092 aircraft registration renewals for the fiscal year, with a 99-percent renewal compliance rate. The Department billed 189 delinquent taxpayers for \$4,710,624. The renewal process has been streamlined from a five-day printing process to a four-hour printing process. The Department has improved the process of issuing certificates of registration for aircraft owners and aircraft dealers, and has reduced the printing cost by 50-percent.

The Department has increased efforts to verify rental exemptions by utilizing more effective technology methods.

Indiana Code 6-6-6.5-2 states that any Indiana resident who owns an aircraft must register the aircraft within 31 days from the purchase date. Any nonresident who bases an aircraft in this state for more than 60 days shall register the aircraft with the Department no later than 60 days after establishing a base in Indiana.

Also of note, the aeronautics section provided assistance to the nonprofit section. The nonprofit section had more than 5,000 suspended transactions to be completed. The current backlog is just over 200 items to be worked.

Corporate Dissolutions

The corporate dissolutions section has received 1,367 notices of corporate dissolution. Indiana Code 6-8.1-10-9 provides that any corporate officer or director becomes personally liable for all taxes, penalties, interest and fees associated with the collection of liabilities for a period of one year from the date the Department is notified of the corporation's dissolution. The corporate officers or directors become personally liable, because the dissolving corporation distributed corporate assets before all liabilities were satisfied. Corporate officers or directors may be absolved of any personal liability by obtaining a Certificate of Clearance from the Department. The Certificate of Clearance certifies that all liabilities due the Department have been satisfied. The Department was able to completely eliminate a backlog of 700 accounts, reducing it to zero.

Reinstatements

Corporations that are administratively dissolved by the Secretary of State's office for noncompliance must obtain a Reinstatement Certificate of Clearance from the Department verifying the corporation is in good standing before they can be reinstated with the Secretary of State. The Department issued 2,664 Certificates of Clearance and denied or closed 1,162 requests due to outstanding issues. Historically, the Department has maintained a backlog of between 200 and 250 accounts, getting clearances out within 20 to 45 days. The current backlog is zero, and clearances have just a few days turnaround time.

Letters of Good Standing

Corporations in the process of obtaining financial loans or other state agency grants or awards approvals will request a Letter of Good Standing. The Department has issued 178 Letters of Good Standing and denied 93 requests due to missing returns or unpaid liabilities.

Responsible Officer Billings

Responsible officer billings were generated for trust taxes representing a total due of \$3,202,549 not paid by corporations.

Federal Audits

If taxpayers do not amend their Indiana corporate income tax returns to report Indiana adjustments resulting from the federal modifications detailed in the federal Internal Revenue Service audit findings, a state tax assessment is generated. For fiscal year 2006, corporate taxpayers were billed a total of \$1,837,749.

Voluntary Compliance Program

Taxpayers who discover that they may have nexus with Indiana, but have not filed returns frequently, must contact the Department to request entering into a Voluntary Compliance Agreement. These taxpayers are often confused or unaware of filing requirements for income tax and/or sales/use taxes in Indiana. Tax due is not forgiven, nor is interest abated. Voluntary Compliance Agreements resulting in \$2,169,583 of taxes collected were entered into for the fiscal year ending June 30, 2006.

Neighborhood Assistance Program

The total neighborhood assistance credits allowed during a fiscal year cannot exceed \$2.5 million. The Indiana Economic Development Corporation verifies donations made to qualified neighborhood assistance organizations. The Indiana Department



of Revenue tracks the donations from various business entities, allowing 50 percent of allowable donations as credits against adjusted gross income tax. The Department processed 5,303 tax credits for the fiscal year.

Bankruptcy Section

The Indiana Department of Revenue's bankruptcy section had a busy and productive year in fiscal year 2006. The changes in the new bankruptcy code that went into effect on Oct. 17, 2005, played a big part in the increase of bankruptcy filings throughout Indiana and the entire nation.

A total of 3,590 bankruptcy claims were filed by the 14 tax analysts in the bankruptcy section in 2006. 10,413 payments were received and accounted for collection of \$23,951,825 on bankruptcy cases.

In all, 8,037 Chapter 7 Asset, Chapter 13 and Chapter 11 claims were filed with net assessments totaling \$104,979,939. There were also 2,875 claims that were amended due to returns being filed.

The bankruptcy section had a total of 167,110 pieces of incoming and outgoing correspondence. The bankruptcy section generated 17,283 pieces of outgoing mail which included faxes and memos to the Attorney General's office, letters and e-mails to taxpayers, attorneys and trustees, and received 149,827 pieces of incoming correspondence from these various outside sources as well as interdepartmental contacts.

As of July 2, 2006, the bankruptcy section had 7,164 active Chapter 7 Asset, Chapter 11 and Chapter 13 cases. The bankruptcy section also closed 4,377 files that were either discharged or dismissed by the bankruptcy court.

Individual/Withholding Tax Operation

The individual income tax section's purpose is to identify and pursue nonfilers, as well as to verify the accuracy of filed returns by utilizing information from the Internal Revenue Service, various Indiana state agencies, other state taxing agencies and anonymous informants. The standard compliance projects and findings for fiscal year 2006 are as follows:

- **Federal Audits**

Information is obtained from the Internal Revenue Service concerning agreed federal tax audit reports to the Department. If taxpayers do not amend their Indiana individual and corporate income tax returns to report the Indiana adjustments resulting from the federal modifications detailed in the audit findings, a tax assessment is generated. For this fiscal year, this section has billed 397 Individual taxpayers for \$595,453.

- **Federal/State Crosscheck**

The Department obtains magnetic tape information from the Internal Revenue Service disclosing adjusted gross income and exemptions reported on the federal returns. This file is compared to the state reported adjusted gross income and exemptions from our master file. Automatic billings are then generated for any state and county tax due on the differences. This project resulted in 6,836 taxpayers being assessed for an amount of \$9,198,351.

- **Individual Desk Examinations**

Individual desk examinations are performed based on anonymous sources or submissions from other divisions within the Department. The examination may consist of verifying income reported, credits/deductions taken, or the amount of refund requested. Individual desk examinations resulted in 12 assessments totaling \$20,023.

- **Riverboat Project**

The Department of Revenue received information from Indiana riverboat companies of the taxpayers who won money on the riverboat for tax years 2001 and 2002. This information was sorted and letters were sent to nonresident taxpayers who had not filed a return with Indiana to report this income. (As of July 1, 2002, Indiana state tax was automatically withheld from winnings over \$1,200.) After sending out approximately 7,000 letters, this section has processed more than \$355,150 in this fiscal year.



Nonprofit/Charity Gaming/Fiduciary Taxes

As of July 1, 2006, the administration of charity gaming transferred to the Indiana Gaming Commission. During the 2006 General Assembly, Indiana legislators voted to transfer the licensing, regulation and enforcement of charity gaming from the Indiana Department of Revenue to the Indiana Gaming Commission.

A total of \$3,414,275 in gaming fees were collected from the 2,434 gaming licenses issued. Civil penalties were collected in the amount of \$62,134.

During fiscal year 2006, the charity gaming section conducted educational/training seminars in Clarksville, Fort Wayne, Indianapolis, Jasper, Lafayette, Michigan City and Richmond. Some of the topics covered included:

- Legislative changes for Charity Gaming
- Revised Publication 2
- Charity-game nights
- 60/60 law
- *Bookkeeping – how it affects your organization*
- Illegal machines
- Revised forms, including CG-8 and CG-21
- Duck races

Nonprofit Section

The nonprofit section processed 1,265 NP20A Nonprofit Organization Applications for Sales Tax Exemption. The nonprofit section collected \$3,484 from IT-20NP Nonprofit Organization Unrelated Business Income Tax returns.

Fiduciary Tax Section

The fiduciary tax section processed 64,518 fiduciary returns for fiscal year 2006, representing a total of \$26,382,189 in taxes collected.

Last year, the fiduciary tax section staff worked with the Department's information technology programmers to convert and update the fiduciary tax database from a FoxPro program to a Visual Basic 6 Software Application on the server. This change has allowed for greater efficiency in processing, researching and editing functions in the section.

Consumer Use Tax, Utility/Trust/Fuel/Sales Refunds

10,953 applications for utility sales tax exemptions were received in FY 2006. More than 92 percent of the applicants qualified for a full (100 percent) exemption on their purchases of public utility services. These applicants were primarily government, nonprofit organizations and companies whose use of the energy was predominately for an exempt purpose.

Approximately 497 business entities, such as restaurants and industrial processors, received less than a 100-percent utility exemption. Companies qualifying for a partial exemption must pay sales tax on their utility bills to their suppliers and then file annual refund claims for exempt percentage allowed. Another 307 applications were denied an exemption on the requested utility service as a result of desk examinations.

Fuel Tax Refunds

3,300 fuel tax refund claims were examined during the year. These claims were filed by government entities, companies and individuals who paid gasoline tax and special fuel tax on fuel subsequently used in an exempt manner.

Trust Tax Refunds

A total of 3,586 trust tax refund claims for \$41,638,279 were received. Of these, 79 percent, or 2,844, totaling \$18,389,216, were reviewed. These resulted in adjustments of \$8,035,217. 309 claims were forwarded to the audit division for review. Another 433 were forwarded to other areas (withholding, corporations or individual) for consideration.

